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MedPAC Releases 2009 Data Book Showing Lowest Hospital Margins Ever

Just as Congress and the Obama Administration are proposing deep cuts in Medicare payments to providers to help finance national health care reform, the Medicare Payment Advisory Commission (MedPAC) has just released its annual data book—*A Data Book: Healthcare Spending and the Medicare Program (June 2009)*—showing a severe deterioration in general hospital Medicare margins.

As shown in Figure 1, the overall hospital Medicare margin fell to negative 5.9% in 2007, the lowest level in the 11 years the Commission has computed this margin. The overall Medicare margin includes acute inpatient services; psychiatric and rehabilitation units; outpatient, skilled nursing facility, and home health services; graduate medical education; and bad debt. MedPAC prefers calculating the overall margin in this way because it believes that hospitals misallocate overhead costs such that the acute inpatient margin is overstated and other service margins are understated. Nonetheless, MedPAC also reported that the acute inpatient margin fell to negative 3.7% in 2007, its lowest level since the inception of the prospective payment system in 1984.

MedPAC believes the margin deterioration is not a particular cause for concern because hospital inpatient cost growth is artificially high as a result of high payments from private payers, as evidenced by a high private payer payment-to-cost ratio (see Figure 2). However, this theory seems implausible because hospital cost growth in 2007 was moderate in the context of the 20-year trend and had been decreasing for five years. Furthermore, the data presented in Figure 2 show that the trend in the private payer payment-to-cost ratio lags behind the trend in Medicare acute inpatient cost growth—suggesting that hospital cost growth is a function of input price pressure as much as,

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Figure 1. **Deterioration in the Overall and Acute Inpatient Medicare Margins**

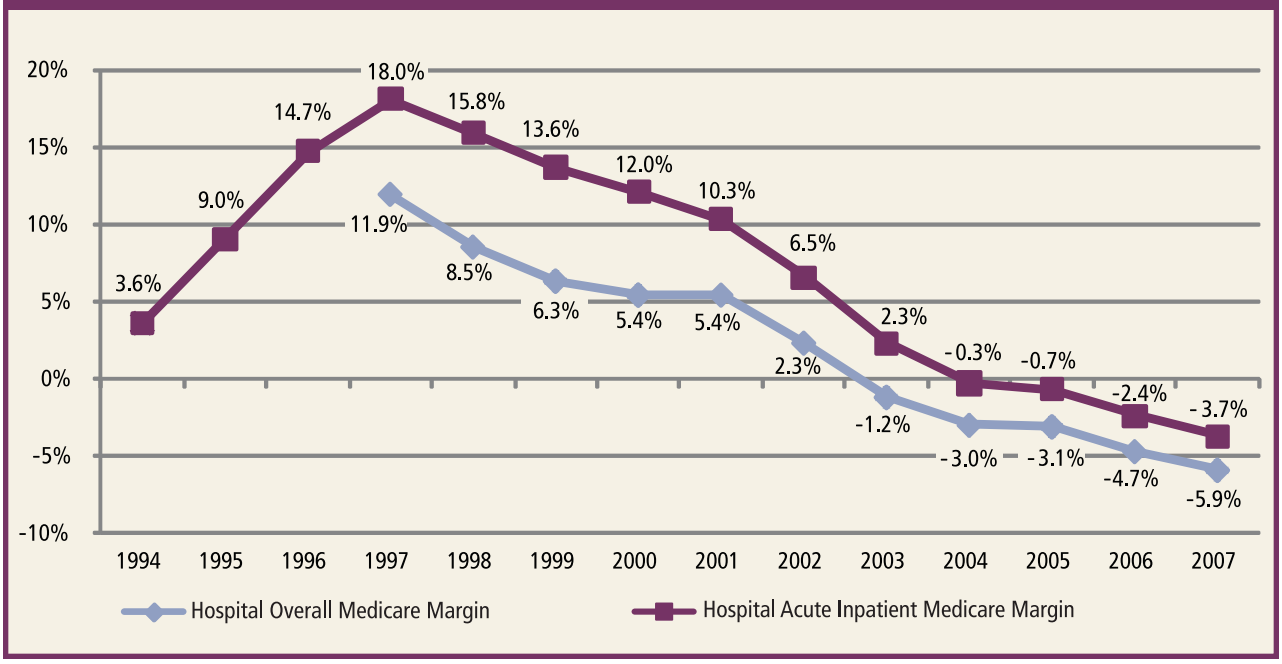
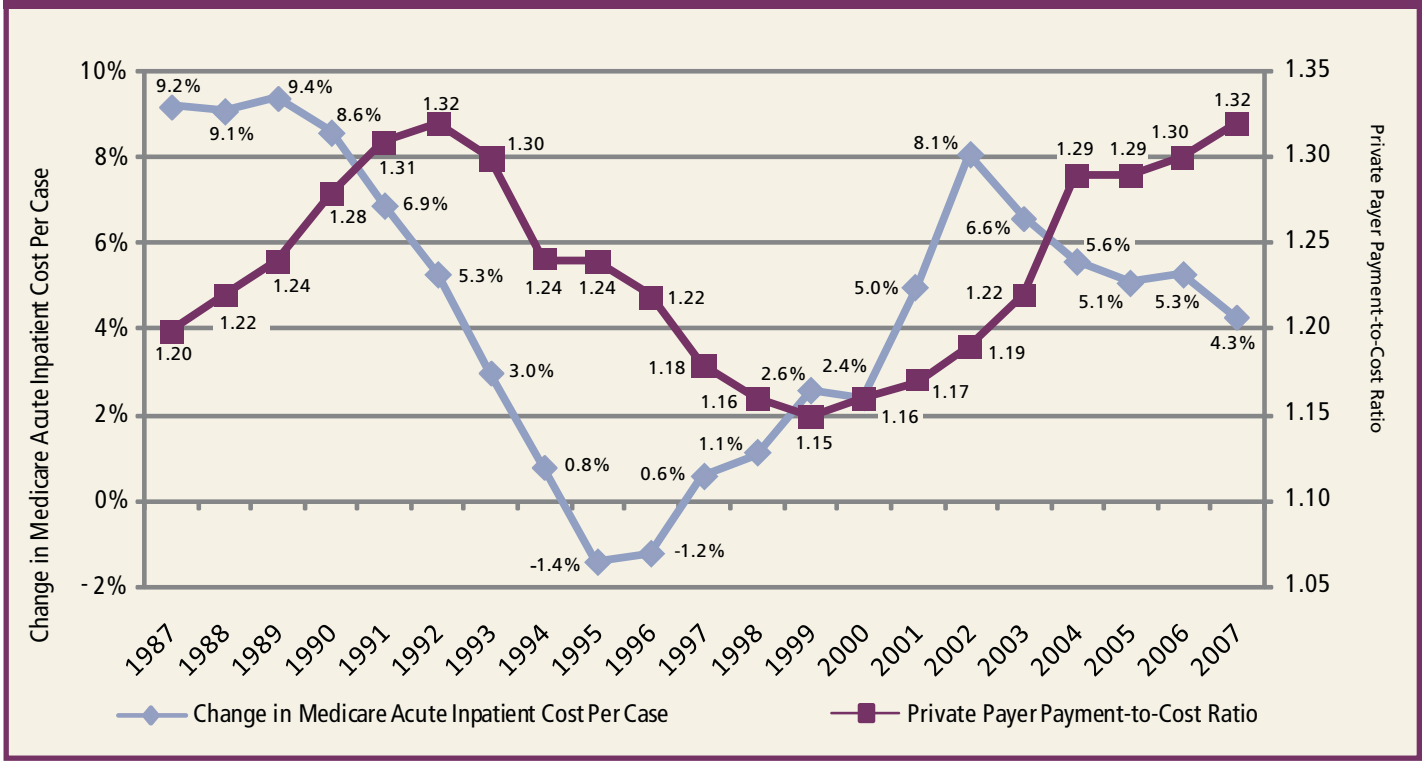


Figure 2. **Medicare Inpatient Unit Cost Growth and the Hospital Margin from Private Payers**

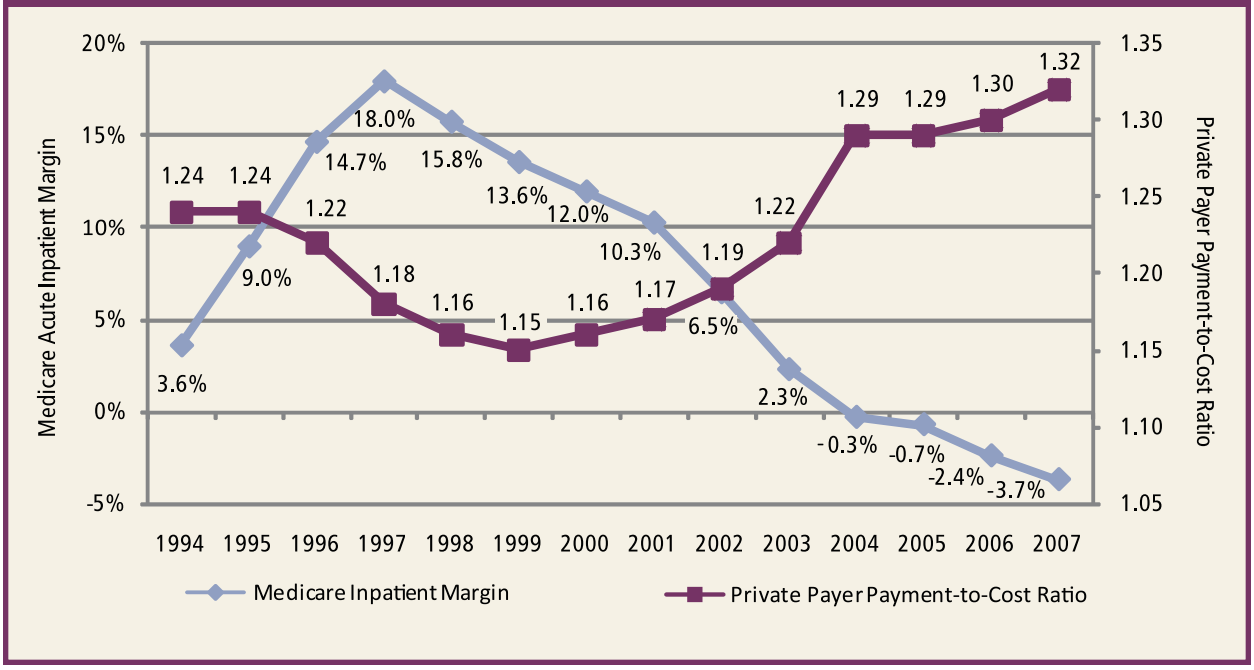


or more than, private payer pressure.

Yet a different interpretation can be inferred from juxtaposing the Medicare acute inpatient margin with the private payer payment-to-cost ratio. As shown in Figure 3, these margins are inversely related, suggesting that hospitals cost shift to private payers as much as possible in response to inadequate Medicare payments.

It is essential that policy makers correctly interpret trends in cost and price growth so they can accurately anticipate the effect of deep cuts in Medicare payments, particularly if an independent MedPAC-like commission ("super-MedPAC") is given virtual autonomy in setting Medicare payment policy, as has been proposed by Blue Dog Democrats and others as part of the national health reform debate (see insert).■

Figure 3. **Medicare Inpatient Margin and the Inpatient Margin from Private Payers**



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